No. 452

In The

Supreme Court of the United States

October Term, 1945

Commissioner of Internal Revenue,

Petitioner,

v.

Charles T. Fisher, Edward F. Fisher and Leo M. Butzel, Executors of the Estate of Fred J. Fisher and Burtha M. Fisher,

Respondents.

On Writ of Certiorari to the United States Circuit Court of Appeals for the Sixth Circuit

BRIEF FOR THE RESPONDENTS

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BRIEF FOR THE RESPONDENTS

Respondents respectfully submit this brief in opposition to the brief on behalf of the Commissioner of Internal Revenue, petitioner.

QUESTION PRESENTED

Petitioner's brief states that the question presented is whether the decision of the court below conflicts with the decision of this court in *Commissioner v. Wheeler*, 3[illegible] U.S. 542. The question presented is much narrower and may be stated as follows:

> Did the court below properly construe Section 501(c) of the Second Revenue Act of 1940 and Treasury Decision 5024 as making inapplicable, in determining respondents' tax liability for 1934, the rules set out in Section 501(a) of that Act, and in Article 115-1, Regulations 86?

STATUTES AND OTHER AUTHORITIES INVOLVED

Statutes and other authorities involved are set forth in Appendix A to petitioner's brief, pages 33-41. Excerpts from the pertinent Congressional Committee Reports are set forth in Appendix B to petitioner's brief, pages 42-52.

STATEMENT OF THE CASE

In the statement of the case in petitioner's brief (pp. 2-5) there appear two statements which are misleading. In the concluding sentence of the first paragraph appearing on page 4 petitioner says "if gain or loss were computed by using the fair market value of those assets as of the date they were exchanged for its stock, Senior Investment Corporation would have had an operating deficit as

of January 31, 1934." From this it might be inferred that Senior Investment Corporation did not in its books and records compute earnings and profits by using as a basis the fair market value of its assets when acquired for its stock. The stipulation between the parties shows that gain or loss was computed on the books of Senior Investment Corporation by the use of corporate cost for assets acquired in exchange for its stock, that the corporation had an adjusted book deficit on June 30, 1933, of $20,530,-234.13, and that its earnings and profits between June 30, 1933, and January 31, 1934, the date of the distribution herein involved, computed on the basis of either corporate cost or transferor's cost, showed a loss (R. 14, 18).

The concluding sentence of the final paragraph of petitioner's statement on page 5 of his brief reads as follows:

> "On June 25, 1945, the Circuit Court of Appeals issued a decision which amended its former opinion but which adhered to its previous disposition of the case on the ground that the corporation's earnings and profits were to be computed in relation to the market value of the assets as of the date they were acquired by the corporation (R. 112-113)."

This is an incorrect statement of the decision by the court below. The Circuit Court on June 25, 1945, did amend its former opinion but adhered to its previous disposition of the case only to the extent that it reiterated its affirmance of the decision of The Tax Court. However, it did not do so on the grounds stated by petitioner. The final opinion of the court below recognized that for all purposes, except the determination of tax liability of a taxpayer whose case was pending on September 20, 1940 or theretofore decided, a corporation's earnings and profits on the disposition of assets acquired in a tax-free ex-

change were to be computed on the basis of transferor's cost. In disposing of the case following the rehearing it affirmed The Tax Court on the ground that the exception found in the last sentence of Section 501(c) of the Second Revenue Act of 1940 and Par. 2 of Treasury Decision 5024 required that neither the rule requiring the use of transferor's cost found in Section 501(a) nor the earlier Regulation (Art. 115-1, Regs. 86), embodying the same rule, were to affect the tax liability of this individual taxpayer whose case was pending on September 20, 1940.

With the above corrections we accept the statement set out in petitioner's brief, with the following additional relevant facts which petitioner has persisted in ignoring both in his petition for certiorari and in his brief:

The distribution of January 31, 1934, to Fred J. Fisher was made pursuant to authority contained in a resolution of the Board of Directors of Senior Investment Corporation, adopted at a duly called special meeting of the Directors held on January 31, 1934, which authorized and directed the distribution and referred to it specifically as a capital distribution. This action of the Directors was approved and confirmed by the stockholders at the annual meeting held on May 8, 1934 (R. 11, 19). Fred J. Fisher and his wife in their joint income tax return for the year 1934 did not report as taxable income the value of the shares distributed to him on the ground that said distribution was a capital distribution to be applied against the cost or basis in the hands of Fred J. Fisher of the shares of Class A stock of Senior Investment Corporation, on which the distribution was made (R. 11).

PETITIONER'S SPECIFICATION OF ERRORS

If the errors to be urged as set out by the petitioner in his brief (p. 6) correctly state his position with respect to error by the court below, then the Commissioner's position in this court is defeated on his own brief. Petitioner says the court below erred (1) in deciding that the corporation here involved was not required to compute its earnings and profits in relation to transferor's cost for assets acquired in a tax-free transaction, and (2) that the corporation did not have sufficient earnings and profits for a distribution to constitute a taxable dividend.

You may search the final opinion of the court below in vain to find any such holding by the Circuit Court. The Court found that Section 501(a) did require "that corporate earnings and profits on the sale of assets of the corporation are to be computed in the year when recognized in the same manner as taxable gains are calculated" (R. 109). Its final opinion affirming The Tax Court was based on the proposition that by reason of the limitation clause in Section 501(c) of the Second Revenue Act of 1940 and Treasury Decision 5024, issued by the Commissioner as an interpretation thereof, the rules prescribed in Section 501(a) and in the earlier Regulation (Art. 115-1, Regs. 86) were not to affect the tax liability of this taxpayer, because of the pendency of this case before The Tax Court on September 20, 1940.

ARGUMENT

1. This Case Is Not Governed by the Decision of this Court in the *Wheeler* Case, Since this Proceeding Was Pending Before the Board of Tax Appeals (Now The Tax Court of the United States) on September 20, 1940, Whereas the *Wheeler* Case Was Not So Pending.

Section 501(c) of the Second Revenue Act of 1940 reads as follows:

> "(c) *Under Prior Acts.*—For the purposes of the Revenue Act of 1938 or any prior Revenue Act the Amendments made to the Internal Revenue Code by subsection (a) of this section shall be effective as if they were a part of each such Revenue Act on the date of its enactment. Nothing in this subsection shall affect the tax liability of any taxpayer for any year which, on September 20, 1940, was pending before, or was theretofore determined by, the Board of Tax Appeals, or any court of the United States."

The petition in the instant case was filed with the Board of Tax Appeals on September 6, 1940. That in the *Wheeler* case was not filed with the Board until May 12, 1941 (Record No. 354, Oct. term, 1944, p. 1). It is apparent, therefore, that this taxpayer comes within the limitation clause and that the *Wheeler* case did not. Upon oral argument in the *Wheeler* case this Court recognized the significance of the limitation clause of Section 501(c). During the argument the following colloquy, which has been taken from a stenographic transcript thereof, occurred between Mr. Justice Jackson and Mr. Whitney, counsel for the Wheeler estate:

"Justice Jackson: You have not told us whether you attach any importance to this tax liability if it is not applied to cases in litigation on September 20, 1940. I ask that, because your case appears to have been in controversy, but had not reached the litigation stage.

"Mr. Whitney: Your Honor, I do not rely on that.

"Justice Jackson: If we were of a disposition to disagree with you on that, would you then rely on that?

"Mr. Whitney: No, your Honor. I think we have really covered the subject."

Since this case was pending on September 20, 1940, this Court must construe and apply Section 501(c) and determine the effect of the exception stated in the last sentence thereof. In *Hellmich v. Hellman*, 276 U.S. 233, 237, this Court referred to the principle as "the long established rule that the intention of the lawmakers is to be deduced from a view of every material part of the statute * * *."

Petitioner in his brief recognizes the necessity of determining the application to the instant case of the exception stated in the last sentence of Section 501(c). Although in his summary of argument (p. 6) he says there is no necessity to resort to the Second Revenue Act of 1940 and nothing in that Act is relied upon to affect the taxpayer's tax liability, elsewhere in his brief (pp. 24-25) he concedes that resort must be had to Section 501(c) and attempts to interpret the exception found in the last sentence thereof in such a way as to render it meaningless.

2. The Court Below Correctly Construed Section 501(c) and Treasury Decision 5024 as Requiring Affirmance of The Tax Court on the Ground that Neither the Rules for Computing Earnings and Profits Found in Section 501(a) Nor Those Found in Article 115-1, Regulations 86, Were to Affect the Tax Liability of This Taxpayer in This Proceeding.

The court below construed the exception clause in Section 501(c) as (1) making the rules in Section 501(a) inapplicable in determining respondents' tax liability, and (2) likewise making inapplicable in determining respondents' tax liability the same rules contained in Article 115-1, Regulations 86. It held that Treasury Decision 5024 applied the saving clause of Section 501(c) to cases governed by Article 115-1, Regulations 86. Based on those conclusions as to the application of Section 501(c) and Treasury Decision 5024, it affirmed the decision of the Tax Court. This construction by the court below is the only interpretation that can be given to the Statute and the Regulation.

Before this Court in the *Wheeler* case the Commissioner argued that (1) the case was governed by Regulations 101, Article 115-3, and that Section 501 of the Second Revenue Act was an approval of the rule stated therein and a clarification of pre-existing law and (2) viewing Section 501 as new legislation, its retroactive application was valid and constitutional. The pertinent portion of that Regulation appeared also in Regulations 94, Article 115-3, under the 1936 Act, and Regulations 86, Article 115-1, promulgated February 11, 1935, under the 1934 Act. This Court in reversing the court below upheld the validity of Article 115-3 of Treasury Regulations 101, and held further that it was intended to and did apply to the facts of that case.

In Subsection (a) of Section 501 Congress amended Section 115 of the Internal Revenue Code by prescribing detailed rules for determining earnings and profits of all corporations, and by Subsection (b) it provided that such amendments were applicable to taxable years beginning after December 31, 1938.

By the first sentence of Subsection (c) Congress provided that for the purposes of all prior Revenue Acts, the amendments made by Subsection (a) should be effective as if they were a part of each such Act on the date of its enactment, for the purpose of "effecting the application of a uniform rule for the determination of the earnings and profits of all corporations for all prior taxable years."[1] After thus stating the general rule Section 501(c) goes on and states the exception in the following language:

> "Nothing in this subsection shall affect the tax liability of any taxpayer which, on September 20, 1940, was pending before, or was theretofore determined by, the Board of Tax Appeals, or any court of the United States."

This sentence clearly provides an exception to the general rule found in the first sentence of the subsection. Viewed in that light, its meaning seems apparent.

In the first sentence of the subsection Congress was stating a rule of general application. The second sentence states an exception to that rule applicable to two limited classes of taxpayers, namely, those with cases theretofore decided by and those with cases then pending before the Board or any Federal court. The language of the exception clause is clear and understandable. As applied to

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[1]Senate Rept. No. 2114, 76th Cong., 3rd Sess., p. 27.

this case it says, that the rules found in Subsection (a) requiring use of transferor's cost which are made effective as if a part of all prior Revenue Acts by the first sentence of Subsection (c), shall nevertheless not affect the determination of tax liability of this taxpayer. The word "affect" is defined in Webster's New International Dictionary, p. 37, as follows: "To lay hold on; to act upon; impress or influence; it is often used in the sense of acting injuriously upon persons and things, 93 U.S. 84." In Bouvier's Law Dictionary, Baldwin's edition, 1934, it is defined as: "To have an effect upon; to act upon; impress or influence; it is often used in the sense of acting injuriously upon persons and things, 93 U.S. 84." This taxpayer in his income tax return determined his tax liability on the theory that corporate cost was the proper method to be used in determining the earnings and profits of Senior Investment Corporation. His tax liability would be affected by the application of the rules found in Subsection 501(a). The exception clause in clear and unmistakable language says that his tax liability shall not be so affected.

It seems equally clear that, looking to the statutory language alone, it has the effect of rendering inapplicable to pending or theretofore decided cases the rule of Article 115-1 of Regulations 86 under the 1934 Act and corresponding Regulations under later Acts. In enacting Section 501 congress was aware of the fact that it was enacting into law the rule as to which the Treasury had previously issued Regulations, but which had been rejected by the Board of Tax Appeals and all Federal courts where the question was litigated.[2] In providing in

[2] H. Rept. No. 2894, 76th Cong., 3rd Sess., p. 41.

the exception clause that the rule first promulgated in Article 115-1, Regulations 86, and made a part of the statute by Subsection (a) of Section 501, should not affect the tax liability of a taxpayer in a case pending on September 20, 1940, it must be presumed that Congress intended that this rule, whether found in such Regulations or in Section 501 itself, should not affect or change the tax liability of such a taxpayer. If any doubt exists from a reading of the statutory language alone, those doubts are resolved when we look to the Treasury's contemporaneous interpretation of Section 501(c) which is found in Treasury Decision 5024 (Pet. Br. 39-41). Par. 2 of that Treasury Decision reads as follows:

> "The above amendments to Regulations 103 (which regulations cover taxable years beginning after December 31, 1938), are hereby made applicable to taxable years beginning prior to January 1, 1939 (such years being covered by Regulations 101, 94, 86, 77, 74, 69, 65, 62, 45, and 33). Although under Section 501(c) the final determination by the Board of Tax Appeals or any court of the United States of the tax liability of any taxpayer for any such taxable year which, on September 20, 1940, was pending before, or was theretofore determined by, the Board of Tax Appeals, or any court of the United States, is not affected by the enactment of Section 501, the rules stated in the regulations are applicable to such cases inasmuch as such rules are a proper interpretation of the law as it existed prior to the enactment of Section 501. *The limitation in Section 501(c) has application only to such taxpayer, and in the case of such taxpayer, only with respect to the tax liability for the specific year or years actually so pending on, or so determined prior to, September 20, 1940.*" (Italics supplied.)

It will be seen that the amendments to Regulations 103, applicable to all years after 1938, are by Par. 2 of the Treasury Decision made applicable to all prior years and the Regulations covering such years. The paragraph then continues by stating that although the tax liability in pending or theretofore decided cases is not affected, the rules stated in the Regulations are nevertheless applicable to such cases. This statement is then followed by the exception reading as follows: "The limitation in Section 501(c) has application only to such taxpayer, and in the case of such taxpayer, only with respect to the tax liability for the specific year or years so pending on, or so determined prior to, September 20, 1940." The Treasury itself has here said in clear and understandable language that although the rules found in the amendments to the Regulations are applicable to cases pending on September 20, 1940 or theretofore decided, the rules, nevertheless, shall be applied in the light of the limitation in Section 501(c) and, therefore, shall not be applied in determining the tax liability of such a taxpayer for the specific year that was pending on September 20, 1940, or theretofore decided.

Although on a first reading, the clause preceding the last sentence of the Treasury Decision may seem inconsistent with the exception stated in the last sentence, this seeming inconsistency disappears when each is given its true meaning. The application of the rules affects many things other than the tax liability of a particular taxpayer in a particular proceeding to which the exception applies. Thus, if a corporation had a case pending on September 20, 1940, involving an issue calling for the aplication of the rules, the rules would be applicable for all purposes

except as they might affect or change the corporation's tax liability for the year involved in that case. The rules *would* be applicable for determining its earnings and profits for all other purposes, such as the taxable status of distributions to its shareholders, unless also included within the exception, and the computation of its equity invested capital for excess profits tax purposes. The House Ways and Means Committee makes this clear when it says that the amendment is important "not only for the purpose of determining whether distributions are taxable dividends but also in determining equity invested capital for excess-profits-tax purposes."[3]

If the case pending were that of an individual shareholder, involving a particular year, the rules would be applicable in determining his corporation's earnings and profits for all purposes, except that they could not affect or change his tax liability for that year. Thus, the rules would be applicable (1) for all purposes as respects the corporation, such as its right to a dividends paid credit if a personal holding company, the computation of its undistributed adjusted net income for the purpose of determining surtax on undistributed profits under the 1936 Act, and the computation of its equity invested capital for excess profits tax purposes; (2) in determining the taxable status of distributions to all other shareholders not likewise within the exception; and (3) in determining the taxable status of a distribution to the same shareholder for another year not then pending or theretofore decided. The Senate Finance Committee, which inserted the exception clause in the Bill, had in mind just such an application of the rules and such a limitation on their application in determining tax liability in pending and

[3] H. Rept. No. 2894, 76th Cong., 3rd Sess., p. 41.

decided cases. In speaking of the shareholder-taxpayer within the exception the Committee report (S. Rept. No. 2114, 75th Cong., 3rd Sess., pp. 26, 27) says: "Section 501 will therefore control for all purposes as respects the corporation, and as respects the shareholder in litigation for every purpose except that the tax liability for the particular year, as finally determined by the Board or the court, will remain undisturbed."

In construing the statutory exceptions the Treasury did not seek to narrow its application beyond providing that the exception had application "only to such taxpayer (with a case pending on September 20, 1940, or theretofore decided) and in the case of such taxpayer, only with respect to the tax liability for the specific year or years actually so pending on, or so determined prior to, September 20, 1940."

The first sentence of Par. 2 of Treasury Decision 5024 provides that "The above amendments to Regulations 103 * * * are hereby made applicable to taxable years beginning prior to January 1, 1939 (such years being covered by Regulations 101, 94, 86, 77, 74, 69, 65, 62, 45, and 33)."

In measuring the significance of that sentence it should be borne in mind that the Regulations under all Acts prior to the Act of 1934, which is covered by Regulations 86, were silent on the question of what constituted earnings and profits. The first Regulation on the subject appeared in Regulations 86, promulgated February 11, 1935.

It must, therefore, be concluded that the amendments to the Regulations incorporated in the Treasury Decision have been engrafted upon and became a part of all prior Regulations, including Regulations 86 under the

1934 Act and subsequent Regulations, as well as Regulations for all prior years which were silent on the question. In the same paragraph of the Treasury Decision, making the amendments to the Regulations a part of all prior Regulations, appears the exception. It necessarily follows that the exception has been made just as much a part of the Regulations for all prior years as of the current Regulations 103, promulgated under the Internal Revenue Code, and that the exception stated in the last sentence of Par. 2 prevents not only the rules stated in Par. 1 of the Treasury Decision but any rules included in earlier Regulations from affecting the tax liability of a taxpayer with respect to a particular year as to which a proceeding was pending on September 20, 1940 or theretofore decided.

This limitation by the Treasury upon the retroactive effect of the rules for determining earnings and profits, set out in Par. 1 of Treasury Decision 5024, and the corresponding limitation on the application of the rules found in prior regulations, rendering them inapplicable in determining tax liability in pending and decided cases, is merely a recognition in the Treasury Decision of the plain meaning of the exception in Section 501(c). However, without the statutory saving clause, the limitation in Treasury Decision 5024 is a valid exercise by the Commissioner and the Secretary of the discretion expressly given them elsewhere in the Internal Revenue Code.

Section 3791(b) of the Internal Revenue Code reads as follows:

> "(b) *Retroactivity of Regulations or Rulings.*—The Secretary, or the Commissioner with the approval of the Secretary, may prescribe the extent,

if any, to which any ruling, regulation, or Treasury Decision, relating to the internal revenue laws, shall be applied without retroactive effect."

The legislative history of this provision commences with Section 1314 of the 1921 Act. That section by its terms permitted the Treasury to apply without retroactive effect a new regulation or a Treasury Decision reversing a prior regulation or Treasury Decision, unless such reversal was occasioned or required by the decision of a court of competent jurisdiction. This section of the 1921 Act was re-enacted without change in Section 1008(a) of the 1924 Act and Section 1108(a) of the 1926 Act.

Section 605 of the 1928 Act amended Section 1108(a) of the 1926 Act by extending the discretion of the Commissioner and the Secretary to cases where the new regulation or Treasury Decision was occasioned or required by a court decision.

Section 506 of the 1934 Act further amended Section 1108(a) of the 1926 Act to read as follows:

> "(a) *Retroactivity of Regulations or Rulings.*—The Secretary, or the Commissioner, with the approval of the Secretary, may prescribe the extent, if any, to which any ruling, regulation, or Treasury Decision, relating to the internal revenue laws, shall be applied without retroactive effect."

This provision remained unchanged thereafter, and is now Section 3791(b) of the Internal Revenue Code, as set out above.

In explaining the meaning of the 1934 amendment the House Ways and Means Committee (H. Rept. No. 704, 73rd Cong., 2nd Sess., p. 39) said:

"This section amends Section 1108(a) of the Revenue Act of 1926, as amended, so as to permit the Secretary, or the Commissioner with the approval of the Secretary, to prescribe the extent, if any, to which any regulation, Treasury Decision, or ruling relating to internal-revenue taxes shall be applied without retroactive effect. * * * Regulations, Treasury Decisions, and rulings which are merely interpretive of the statute, will normally have a universal application, but in some cases the application of regulations, Treasury Decisions, and rulings to past transactions which have been closed by taxpayers in reliance upon existing practice, will work such inequitable results that it is believed desirable to lodge in the Treasury Department the power to avoid these results by applying certain regulations, Treasury Decisions, and rulings with prospective effect only."

The question of the Treasury's rule-making power and of the discretion given the Commissioner and the Secretary to limit the retroactive effect of regulations is exhaustively treated in Paul's "Selected Studies in Federal Taxation," Second Series, pp. 76-103. There, in commenting on the legislative history of Section 3791(b) of the Internal Revenue Code, the author says at pp. 81-82:

"This legislative history leaves little doubt as to the intention of Congress. It seems clearly to have realized at a relatively early date the hardship involved in the Old Blackstonian theory of judicial decisions, especially in a rapidly evolving branch of law like taxation—a branch of law receiving its education only after much delay from so many different, and differing, tribunals. We do not know whether Congress recognized the possibility that the courts might themselves disregard tradition and make their decisions prospective; if it did, Congress seems to have been unwilling to

put complete trust in this possibility, and to have extended to the Commissioner a broad discretion to grant relief in meritorious cases in which a retroactive application of a court decision would create havoc among innocent taxpayers who relied in good faith upon a current explanation of the statute or constitution."

Further, at page 92, the author says:

> "The equity and fairness of giving the Commissioner power to make regulations non-retroactive would appeal strongly to any court, especially in the not uncommon cases where there may have been a detrimental reliance on former court decisions and regulations almost in the nature of an estoppel."

The author's comments on the intent of Congress and on the equity and fairness of the power given the Commissioner might well have been made in the light of the situation presented in this case.

In the instant case the taxpayer and his corporation were relying upon a rule for the determination of earnings and profits of a corporation well established by court decisions rendered before January 31, 1934, the date of the distribution. The distribution was made by Senior Investment Corporation pursuant to authority contained in a resolution of the Board of Directors which authorized and directed the distribution and referred to it specifically as a capital distribution (R. 11, 19). The taxpayer and his wife did not report the distribution as taxable income in their joint income tax return for 1934, on the ground that it was a capital distribution to be applied against the basis in the taxpayer's hands of the shares on which the distribution was made (R. 11).

It was a matter of common knowledge that "earnings and profits" and "taxable net income" of a corporation were not synonymous terms. That fact was recognized by Treasury Regulations of long standing. Congress in Section 204 of the 1924 Act, the predecessor of Section 113 of the 1934 Act, prescribed an adjusted basis for computing the taxable net income of corporations on the sale or exchange of assets acquired in a transaction in which the gain to the corporation was not recognized under Section 203, the predecessor of Section 112 of the 1934 Act. Congress did not see fit, however, in any Act prior to the Second Revenue Act of 1940 to define the term "earnings and profits" as used in Section 115 of the 1934 Act relating to dividends, and the first Regulation promulgated by the Treasury seeking to define or limit the meaning of that term was contained in Article 115 of Regulations 86, promulgated February 11, 1935, more than one year after the distribution involved in this case.

Contrary to petitioner's assertion (Pet. Brief, p. 23), the taxpayer had a right to rely upon an established judicial interpretation of the term "earnings and profits" found in cases decided before January 31, 1934. Numerous cases theretofore decided had held that the term "earnings and profits" was synonymous with the term "surplus", and that earnings and profits were to be determined in accordance with accepted methods of corporate accounting, recognizing as corporate capital the value of assets when acquired in exchange for stock. *Edwards v. Douglas*, 269 U.S. 204 (Nov. 23, 1925); *Willcuts v. Milton Dairy Company*, 275 U.S. 115 (Nov. 21, 1927); *Helvering v. Canfield*, 291 U.S. 163 (Jan. 15, 1934); *Realty Sales Company*, 10 B.T.A. 1217 (March 18, 1928); *Charles F. Ayer*, 12 B.T.A. 284 (June 1, 1928); *Mead*

Realty Company, 21 B.T.A. 1062 (January 6, 1931); *Reliance Investment Company*, 22 B.T.A. 1287 (April 23, 1931).

In *W. S. Farish & Company v. Commissioner*, 38 B.T.A. 150, aff. 104 F. (2d) 833, which petitioner contends is the first decision on which this taxpayer could have placed reliance, the decision of The Tax Court is based on the proposition that the above cited decisions compelled the conclusion it reached that the earnings and profits of Farish on the sale or exchange of assets acquired for its stock must be computed by reference to corporate cost. Moreover, the question of the effect on earnings and profits of a realized but unrecognized gain was directly involved in the case of *Forhan Realty Corporation* (Memo B.T.A. Op.; unreported; Docket No. 60975; June 16, 1933), reported on appeal when affirmed by the Circuit Court of Appeals for the Second Circuit, Feb. 4, 1935, 75 F. (2d) 268. In that case both the Board and the Court held that the unrecognized gain was to be taken into the earnings and profits account on the basis of corporate cost. The issue in the *Forhan* case was identical with that later decided the same way in *F. J. Young Corporation*, 35 B.T.A. 860, aff. 103 F. (2d) 137. In those cases the question was whether a corporation realizing a corporate gain on an exchange in which such gain was not taxable under Section 112, should include such gain in its earnings and profits account for dividend purposes. In the instant case the question is whether a gain to Fisher on the exchange of assets for stock of his corporation not taxed to him under Section 112 should be included in the earnings and profits account of the corporation, when it sells such assets.

In his brief herein (p. 24) petitioner says that in the face of the opposite rule being applied by the Board

and the courts the Commissioner persisted in applying the Regulation. A review of the decided cases shows that he was applying his Regulation only to cases with factual situations such as in the *Young Corporation* case, and that he did not apply or rely upon his Regulation in cases with factual situations such as in the instant case until after the enactment of the Revenue Act of 1940. The first case involving the factual situation of the instant case in which he relied upon the Regulation was that of *Falkland Corporation v. Commissioner*, Memo T.C. Op.; CCH Dec. 12179-A (November 8, 1941). He did not rely on the Regulation in *W. S. Farish & Company, supra* (July 22, 1938); *A. & J., Inc. v. Commissioner*, 38 B.T.A. 1248 (November 20, 1938), or *Dorothy Whitney Elmhirst*, 41 B.T.A. 348 (February 14, 1940), all with factual situations like that in the instant case. However, in the case of *F. J. Young Corporation, supra*, (April 9, 1937), he did rely upon the Regulation, and the Regulation was rejected as controlling there by both The Tax Court and the Court of Appears for the Third Circuit.

There can be no question but that the taxpayer here had the right to, and did, rely upon an established interpretation which held that corporate earnings and profits were to be determined by reference to corporate cost.

This case presents an unusual factual situation justifying the application of the exception clause for determination of tax liability in such a way as to make it unaffected by the rules found in the 1940 Statute, as well as those in the Regulation promulgated for the first time more than one year after the distribution in question. The taxpayer here filed his return and computed his taxes on the basis that corporate cost was the proper method for computing the earnings and profits of his corporation, in reliance upon what he had reason to believe was a

well settled and established rule. In that respect he is in a different situation from either that taxpayer whose transaction took place after the promulgation of the first Regulation in February, 1935, and whose right to rely on the previously established interpretation might be questioned, or the taxpayer who, in determining his tax liability on his return, had used the method of transferor's cost, and whose liability would not be *affected* by the application of the rule now alleged to have been adopted administratively in February, 1935, and adopted by Congress in October, 1940. If the taxpayer here had filed his return on the assumption that transferor's cost was the proper method of computing the earnings and profits of his corporation, petitioner's position undoubtedly would be that he did not fall within the exception clause, since the application to him of the rules found in Section 501(a) or the prior Regulation would not *affect* his tax liability.

The Commissioner, with the approval of the Secretary, under Section 3791(b) of the Internal Revenue Code had the express right to prescribe the extent, if any, to which any rule or regulation shall be applied without retroactive effect. The language of the Treasury Decision indicates the intention by the Treasury to limit the application of the rules found in Section 501(a) so that they would not affect the tax liability of pending or theretofore decided cases; and, as to those cases, to likewise limit the effect of his prior Regulations on the subject. Such an interpretation is in accord with the view of this Court expressed in *Helvering v. Credit Alliance Corporation*, 316 U.S. 107, wherein this Court said:

> "Section 115(h) was amended in 1938, 26 U.S.C.A., Int. Rev. Acts, page 1058, subsequent to the consummation of the transaction here in

question, to include money or property, but we cannot, as the Government suggests, read into the section, as it stood when the transaction took place, an intent derived from the policy disclosed by the subsequent amendment."

In petitioner's brief (pp. 10, 11) reliance is placed upon the statement by Mr. Justice Jackson in the *Wheeler* opinion that "indeed Congress appears to have provided for this result in the Statute itself (Section 111(c) of the 1938 Act) which declares: 'In the case of a sale or exchange the extent to which the gain or loss determined under this Section shall be recognized *for the purposes of this title* shall be determined under the provisions of Section 112'." However, that statement of Mr. Justice Jackson, when read in its context, demonstrates that it was not the basis of this Court's decision. Its decision rested solely on the proposition that the Regulation was valid and governed the *Wheeler* case on its facts. We believe that the statement respecting Section 111(c) in the Court's opinion was no more than a conjecture as to the intent of Congress.

As a matter of fact, that phrase and similar expressions such as "under this title" and "as used in this title" are contained at least twenty times in the Revenue Act of 1934. Its unimportance as a substantive provision is highlighted by the fact that the Committee Reports with respect to §202(d) of the Revenue Act of 1924 (the predecessor of §111(c)) omit the phrase altogether in paraphrasing the section. For instance, the Senate Finance Committee Report (Senate Report 398, 68th Cong., 1st Sess., p. 13) states:

> "(4) Subdivision (d) 111(c) is merely informatory, stating that the amount of the gain deter-

> mined under its provisions shall be recognized as provided in Section 203 (112), which states those cases in which no gain or loss from a sale or exchange is recognized and those cases in which a limitation is placed upon the gain or loss to be recognized from the sale or exchange."

The meaning of the phrase "for the purposes of this title" and similar expressions becomes apparent when we look upon the pattern used in Revenue Acts. Thus, the 1934 Act consisted of six Titles. Of those, Title I relates to income taxes, Title IV, to excise taxes, Title V, to capital stock and excess profits taxes, etc. The broadest meaning that can be attributed to the clause as used in Section 111(c) is that the gain or loss is to be determined under the provisions of Section 112 for the purpose of determining the *income tax* liability of the taxpayer realizing such gain or loss. In other words, Congress was merely providing that the provisions of that subsection applied for the purpose of computing the *income tax* liability of the taxpayer involved at rates prescribed elsewhere in that Title.

During the history of this case petitioner has urged three inconsistent positions with respect to the meaning of the exception found in Section 501(c). In his brief in the Circuit Court (pp. 25-26) he said that the only reasonable explanation of the exception in that subsection "is that the exception was enacted because Congress, quite rightfully, did not believe that it would be proper for it to dictate to the Judiciary the manner in which the courts should decide controversies over which jurisdiction had already been taken or to interfere with decisions already reached. * * * Because Congress refused to interfere with the jurisdiction of the courts to decide pending

cases which, of course, includes their jurisdiction to err, it does not mean that Congress intended to direct or urge the courts to make a wrong decision." On brief in the court below the taxpayer pointed out that this theory is not in accord with Congressional policy as indicated by numerous amendments to the Revenue laws which directly affected cases then in litigation, and even went so far as to nullify decisions theretofore rendered by this Court and authorize refunds of taxes already collected. A notable example showing absence of that deference to the Judicial branch is found in Section 134 of the Revenue Act of 1943, amending Section 167 of the Internal Revenue Code and nullifying the decision of this Court rendered shortly prior thereto in *Commissioner v. Stuart*, 317 U.S. 154. In fact, the amendment makes refundable taxes theretofore collected on the basis of the rule adopted in that decision. The taxpayer further pointed out that this interpretation of the meaning of the limitation clause in effect amounted to Congressional sanction to decisions of The Tax Court or other lower United States courts in determining tax liability in all such cases pending on September 20, 1940 or theretofore decided. Moreover, the taxpayer urged that this amounted to the adoption by Congress of a rule respecting the finality of decisions of The Tax Court and other lower courts, within the particular limits set out in the exception clause, comparable to the rule announced by this Court in *Dobson v. Commissioner*, 320 U.S. 489.

In his petition for certiorari petitioner abandoned the interpretation he had urged in the Circuit Court and there interpreted the legislation and his Regulations thereunder as merely providing that "if there should be an erroneous final decision in favor of a particular taxpayer in a case pending on September 6 (20), 1940, or

already decided, the finality of the decision would be limited to the particular year involved and *res judicata* would not operate to give him (or other stockholders in the same corporation) a vested right in the wrong method of computing earnings and profits for all other taxable years" (Petition, p. 12).

The unreasonableness of this interpretation was pointed out in the taxpayer's brief in opposition to the petition for a writ. Under that interpretation of the exception Congress intended it merely as a protection for the Government, designed to prevent corporate taxpayers or their shareholders, whose liabilities had been determined by a computation of corporate earnings and profits on a method other than that prescribed in Subsection 501(a), from invoking the doctrine of *res judicata* in cases later arising. The language of the exception itself shows clearly that it was not intended as protection for the Government but as protection for taxpayers within two limited classes, namely, those whose liabilities (1) had theretofore been determined, or (2) were in litigation and pending on September 20, 1940. The Conference Report on the Bill expressly refers to the second sentence of Section 501(c) as an exception, saying:

> "The House recedes with an amendment providing that the *exception* added by the Senate amendment relative to pending or decided cases shall apply * * *."[4] (Italics supplied.)

Other considerations demonstrate the error of attributing to Congress such an intent in the enactment of the exception. If that had been its intent the exception would not have been limited to cases pending on September 20,

[4] H. Conf. Rept. No. 3002, 76th Cong., 3rd Sess., p. 2.

1940 or theretofore decided, since there was as much likelihood of "an erroneous final decision" in cases arising after September 20, 1940, or thereafter decided, as in cases pending on September 20, 1940, or theretofore decided. Moreover, assuming that intent, it could and would have been stated in more clear, simple, and positive language, namely that "no decision in any case decided by the application of a rule for determining earnings and profits of a corporation contrary to those set out in subsection (a) of this section shall be *res judicata.*"

Petitioner in his brief herein has again changed his position with respect to the meaning of the exception. He now admits for the first time (Pet. Br. p. 25) that "Congress believed that it was restating existing law, but recognized that this view might be judicially rejected." He now interprets Congressional intent as evidencing a willingness to enact the rule into all prior Revenue Acts, to be applicable to all future cases where earnings and profits of prior years might be involved, but as evidencing a belief that it was not desirable to extend the express enactment to cases which were already in litigation. He says, with respect to the reference in the exception clause to cases *theretofore decided*, that although Section 501 *probably* would not have affected such cases, Congress, out of legislative caution, provided that the tax liability involved in those cases should not be affected by the enactment of Section 501, and with respect to cases in litigation, but in which final judgments had not been entered, that the courts were to be left free to decide the case according to existing law, without resorting to Section 501 to affect the tax liability involved.

It seems strange that petitioner, who by law is charged with the interpretation and administration of the Statute,

has finally, after the lapse of approximately four and one-half years, evolved an interpretation of Congressional intent entirely inconsistent with other views of Congressional intent which he has previously urged upon the courts.

In reply to respondent's statement in the brief in opposition to the petition for a writ that on the theory of legislative intent urged in the petition Congress would be guilty of absurd legislative practice, petitioner says in his brief (p. 24) that respondent's argument overlooks the fact that enlightened hindsight is scarcely a test of the wisdom of prudent forethought. However, it is on the basis of petitioner's present enlightened hindsight in view of the *Wheeler* decision that he now evolves his theory of Congressional "prudent forethought." Since it was established by the *Wheeler* case that there is no necessity to view Section 501 as retroactive legislation, he now seeks to impute to Congress an intent to give meaning to the exception only if Section 501 were to be construed as new legislation retroactively applied.

His latest theory of Congressional intent which he now urges on this Court is just as unconvincing as the previous theories which he has advanced. If a final judgment had been entered in a case before the enactment of Section 501 such final judgment could in no way be affected by the legislation, a circumstance of which the Congress must have been fully aware. To say, as petitioner says, that the reference in the exception clause was included "out of legislative caution" is attributing to Congress an intention to include in the legislation futile and unnecessary provisions. Likewise, it seems apparent that in stating the exception as applied to cases pending, Congress did not merely intend that the courts "were left

free to decide the case according to existing law, without resorting to Section 501(a) to affect the tax liability involved." So interpreting the reference to pending cases, Congress was not conferring on the courts any jurisdiction which they did not already have. The courts, without the exception clause, were at perfect liberty to decide cases on the basis of existing law without resorting to Section 501. For example, a court then having jurisdiction or later acquiring jurisdiction over a case involving the year 1934, could hold that the pre-existing law was contrary to the rules stated in Section 501 and for that reason Section 501 could not be viewed as clarifying legislation. Again, considering the Section as new legislation applied retroactively, The Tax Court or any Federal court could hold the retroactive application valid or invalid, and in every respect could exercise the same judicial function, with the same freedom of action, as though the exception clause had not been included in Section 501(c).

Indeed, the petitioner's present argument with respect to the meaning of the limitation clause defeats his own case. If the reference to cases *theretofore determined* in the clause "which, on September 20, 1940, was pending before, or was theretofore determined by, the Board of Tax Appeals, or any court of the United States" refers to cases in which final judgments had already been entered, then there can be no question but that Congress intended that in the determination of tax liability in cases pending on September 20, 1940, earnings and profits were to be computed by reference to corporate cost. At the time of enactment of Section 501 Congress was aware of the fact that in all cases involving the question theretofore decided by the Board of Tax Appeals and the Federal courts tax liabilities had been determined by

use of corporate cost in determining earnings and profits on the sale of assets acquired for stock.[5] Since in all cases theretofore decided earnings and profits had been computed by reference to corporate cost as a basis, it necessarily follows under petitioner's theory that Congress intended the same basis should be used in determining tax liability in pending cases and those decided (but not finally), since all three classes of cases are referred to in the sentence stating the exception.

3. In Enacting the Exception Congress Intended that the Use of Corporate Cost in Computing Earnings and Profits Was at Least Permissive in the Determination of Pending and Theretofore Decided Cases, Thereby Applying Legislatively a Rule Similar to that Applied by this Court in *Dobson v. Commissioner.*

In the instant case, unlike the *Wheeler* case, The Tax Court decided in favor of the taxpayer, and held that in determining Fisher's tax liability earnings and profits were to be computed by reference to corporate cost. In so doing it considered the application of the exception clause in Section 501(c), as well as the long line of cases theretofore decided by it and the Federal courts. It further concluded that by reason of the exception clause the rule in Article 115-1 of Regulations 86 was not to be applied. The Tax Court in reaching its conclusion was viewing Section 501 both as retroactive legislation and as clarifying legislation. In the earlier case of *Falkland Corporation, supra,* with facts on all fours with the instant case, The Tax Court held that, viewed as clarifying legislation, the limitation in Section 501(c) of the Second Revenue Act of 1940 would make it clear error to apply the rule requiring the use of transferor's cost to a case

[5] H. Rept. No. 2894, 76th Cong., 3rd Sess., p. 41.

pending on September 20, 1940. In this connection The Tax Court said:

> "But even if we assume that there was some intent to clarify the pre-existing law, we think it clear that no effect can be had upon the instant proceeding, for Section 501(c), although specifically providing that subsection (a) (in effect providing for the use of adjusted basis in determining earnings and profits under Section 115) shall be effective as a part of prior revenue acts, goes on to provide specifically that nothing in such subsection 'shall affect the tax liability of any taxpayer for any year which, on September 20, 1940, was pending before, or was theretofore determined by, the Board of Tax Appeals, or any court of the United States.' This is such case, and it would be clear error, we think, in the light of such statute, to hold that the statute of 1940 affects the tax situation of the present taxpayer."

Congress and this Court have long been aware of the specialized knowledge possessed by members of The Tax Court. As pointed out by this Court in its recent decision in *Kelley v. Commissioner,* and *Talbot Mills v. Commissioner,* .... U.S. ...., decided January 7, 1946, Congress as early as 1926 recognized this fact and enlarged the finality of the Board of Tax Appeals decisions from "prima facie evidence of the facts therein" to reviewability only "if the decision of the Board is not in accordance with law." In commenting there on Congressional recognition of the Board's special qualifications, this Court in footnote 7 to its opinion quoted the following from the report of the Ways and Means Committee in connection with the Revenue Act of 1926.[6]

> "Inasmuch as the complicated and technical facts governing tax liability require a determination by

[6] H. Rept. No. 1, 69th Cong., 1st Sess., pp. 19-20.

a body of experts, the review is taken directly to an appellate court, just as, for instance, in the case of orders of the Federal Trade Commission, and orders of the Secretary of Agriculture under the packers and stockyards act. In view of the grant of exclusive power to the board finally to determine the facts upon which tax liability is based, subdivision (b) of Section 914 limits the review on appeal to what are commonly known as questions of law. The Court upon review may consider, for example, questions as to the constitutionality of the substantive law applied, the constitutionality of the procedure used, failure to observe the procedure required by law, the proper interpretation and application of the statute or any regulation having the force of law, the existence of at least some evidence to support the findings of fact, and the validity of any ruling upon the admissibility of evidence (see subdivision (a) of Section 907 and subdivision (b) of Section 914) (§1003(b) of the Act as passed). The Court, therefore, may adequately control the action of the administrative officer or agency, but will not be burdened with the duty of substituting its opinion for that of the Board upon the evidence."

In applying the rule of *Dobson v. Commissioner, supra*, and giving finality to decisions of The Tax Court on the question of whether certain corporate securities were corporate bonds or preferred stock, this Court in the *Kelley* case said:

"The illustrations in the report, note 7, *supra*, are legal questions without doubt, except the possibility that the words 'application of the statute or any regulation having the force of law' may be thought to give a reviewing court power to pass upon the Tax Court's conclusion from the primary or evidential facts. So that in the present cases, it

might be said to be a question of law as to whether the primary facts adduced made the payments under consideration dividends or interest. But we think such conclusion gives inadequate weight to the purpose of The Tax Court. The finality of The Tax Court's rulings was being enlarged by the 1926 Act. The then Board was spoken of as an impartial and independent tribunal of experts 'for the determination of tax liabilities as between the government and the taxpayer.' H. Rep. No. 1, 69th Cong., 1st Sess., p. 17. There would hardly need to be experts in tax affairs to decide questions of dates or amounts or values or to calculate rates. Their usefulness lies primarily in their ability to examine relevant facts of business to determine whether or not they come under statutory language. Adequate reason for the use of the word 'application' of course exists in situations where true legal questions arise, as in whether an act applies to transfers antecedent to its enactment or to income or estate taxes from trusts or to situations which involve conflicts of law. There is nothing in the context in which the word 'application' is used which suggests to us that it should be given its widest connotation."

There this Court said that the conclusion of The Tax Court with respect to whether certain corporate obligations were for tax purposes bonds or preferred stock, based upon its *application* of the Statute to the facts of each case, was not subject to review. Here there is involved the *application* of the exception in Section 501(c) to the facts in the instant case. The Tax Court's decision is entitled to the same finality in the instant case as in the *Kelley* and *Talbot Mills* cases. In the instant case The Tax Court applied the exception to the facts in the case. Based on that *application* it concluded that the tax liability would be affected by applying the rules of

Section 501(a) or Article 115-1, Regulations 86, and that the exception expressly required that tax liability should not be so affected.

Congress was also aware of the fact that the term "earnings and profits," in the absence of statutory definition, involves a pure accounting concept and, therefore, a question of fact, and that the Board and the courts had been holding that the term was not defined in any prior Revenue Act. It had been so held in a number of cases. In *R. M. Weyerhauser*, 33 B.T.A. 594 (November 29, 1935), the Board said:

> "* * * It is apparent, therefore, that 'taxable net income' is purely a statutory concept.
>
> "Earnings and profits, on the other hand, are not defined by the Act; *but they have a settled and well defined meaning in accounting* * * *." (Italics supplied.)

With this knowledge and in recognition of the fact that the Board of Tax Appeals, with its specialized knowledge in the field of tax law, had consistently been requiring the use of corporate cost in computing earnings and profits, and that the appellate courts without exception had accepted the Board's informed judgment, Congress by the limitation clause was at least giving Congressional sanction to decisions in cases theretofore decided (but as to which the time for appeal had not expired)[7] and in

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[7]It is significant in this regard to note that the Treasury Department did not appeal from the decision of the Board entered May 17, 1940, in the case of Dorothy Whitney Elmhurst, 41 B.T.A. 348. The Board there upheld the use of corporate cost as the proper basis for computing earnings and profits of her corporation. One year involved was 1934, as in the instant case. Time for appeal expired during the pendency before Congress of the Second Revenue Act of 1940. Although the taxpayer appealed on other issues the Treasury did not appeal, indicating that it then construed the saving clause, respecting cases theretofore decided, as making the Board's decision final and conclusive on the question. In settling the taxpayer's appeal on a stipulation filed July 31, 1941, the Treasury accepted and gave effect to the Board's decision that corporate cost was the proper basis.

cases pending on September 20, 1940. Even if not prescribing that method, it was at least providing that the use of such method was permissive, and cases so decided were entitled to finality.

The decision of The Tax Court in the instant case, based upon its application of the exception clause, did not establish a rule of general application to a large class of taxpayers. The rule there established applies only to the very limited class of taxpayers with cases pending on September 20, 1940, or theretofore decided (but not finally), and which involved the particular issue present here. The fact that the rule is one of limited application is seemingly shown by the fact that, aside from the instant case, only three of such cases have been considered and passed upon by The Tax Court. *Dorothy Whitney Elmhirst, supra; Falkland Corporation, supra; Senior Investment Corporation*, 2 T.C. 124.

In this respect The Tax Court's decision herein should be viewed in the same light as its decision in the *Kelley* and *Talbot Mills* cases. The Tax Court's decision herein satisfies the test laid down by this Court in its decision in *Dobson v. Commissioner, supra*, wherein it said:

> "But 'the judicial function is exhausted when there is found to be a rational basis for the conclusions approved by the administrative body'."

The exercise by the Board of final jurisdiction in cases subject to its review was not then unprecedented, and such final jurisdiction has since been given The Tax Court in other matters. It exercised final jurisdiction in its review of determinations by the Commissioner under Sections 327 and 328 of the Revenue Act of 1918, being the excess profits tax relief sections. Congress by Sec-

tion 900(e) of the Revenue Act of 1924 had conferred on the Board jurisdiction to review determinations by the Commissioner, and this Court in *Blair v. Oesterlein Machine Company*, 275 U.S. 220, held that such jurisdiction extended to determinations under Sections 327 and 328. In *Williamsport Wire Rope Company v. Commissioner*, 277 U.S. 551, this Court held that such determinations were not reviewable by the courts, saying:

> "Thus the aims which induced Congress to enact §§327 and 328, the nature of the task which it confided to the Commissioner, the methods of procedure prescribed, and the language employed to express the conditions under which the special assessment is required, all negative the right to a review of his determination by a court."

The Tax Court was granted final jurisdiction under Section 403(e) (1) of the Renegotiation Act of 1942, as amended, c. 247, 56 Stat. 245, in cases involving the determination of excessive profits on war contracts or subcontracts.

It seems clear, as argued hereinbefore, that by reason of the exception clause the courts were expressly prohibited from affecting respondents' tax liability by application of the rules found either in Section 501(a) or in the prior Regulations. The decision below can be affirmed, however, on a narrower interpretation of the exception, namely, that Congress intended by the exception to give finality to decisions in cases theretofore decided (but not finally); and as to cases pending on September 20, 1940, to make decisions therein applying the rule for determining earnings and profits theretofore consistently applied by all courts, permissive and final. In the words of the Senate Finance Committee Report: "These cases

now actually in litigation are left to be determined as the Board or the Court may see fit."[8]

CONCLUSION

The petitioner criticizes the reasoning used in the opinion of the Court of Appeals. We do not believe such criticism to be justified. However, the decision of that Court affirming the Tax Court correctly disposed of the case. In a review of Judicial proceedings the rule is well settled that if the decision below is correct it must be affirmed, even though the lower court relied upon a wrong ground or gave a wrong reason. *Helvering v. Gowran*, 302 U.S. 238; 9 Mertens, Par. 51.31.

The judgment of the Circuit Court of Appeals should be affirmed.

Respectfully submitted,

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[8] S. Rept. No. 2114, 76th Cong., 3rd Sess., p. 26.

SUPREME COURT OF THE UNITED STATES.

No. 452.—October Term, 1945.

Commissioner of Internal Revenue, Petitioner, *vs.* Charles T. Fisher, Edward F. Fisher, and Leo M. Butzel, Executors of the Estate of Fred J. Fisher, and Burtha M. Fisher.	On Writ of Certiorari to the United States Circuit Court of Appeals for the Sixth Circuit.

[March 11, 1946.]

Mr. Justice Black delivered the opinion of the Court.

In 1934 the Senior Investment Corporation, organized in 1929 by one Fisher and his wife for family investment purposes, distributed to Fisher 43,300 shares of General Motors stock valued at $1,723,881.25. Fisher and his wife made a joint tax return but did not report this amount as income. The taxpayers contended that since the Senior Investment Corporation showed a book deficit for 1934, the distribution in question was a "capital distribution" and not a corporate dividend from "earnings and profits," which latter was the type of distribution taxable under Section 115 (a) of the then controlling tax law. 48 Stat. 680, 711. The Commissioner decided that the following circumstances justified a finding that the distribution was taxable as a dividend from "earnings or profits": When the Senior Investment Corporation was organized Fisher and his wife paid for their shares of stock with securities which had cost them $14,500,000, but had by the date of organization acquired a market value of $88,000,000. To show that the corporation had a deficit and that consequently the distribution of General Motors stock was not from "earnings or profits," the taxpayers used the corporation's computation based on the $88,000,000 rather than the $14,500,000 figure. The Commissioner decided that the $14,500,000 cost to Fisher and his wife of the securities they transferred to the corporation in exchange for shares of its stock was the proper base for ascertaining whether the corporation could make a distribution from profits; that the use of that figure would show a surplus in 1934; and that the distribution of the General Motors stock was therefore a taxable dividend from "earnings or profits." On review the Tax Court following its prior holdings rejected the Commissioner's argu-

ment and decided for the respondents. The Circuit Court of Appeals affirmed. 150 F. 2d 198.

Since Section 112 of the Revenue Act of 1934 did not tax the gain resulting from transfers of property to a corporation in exchange for stock in that corporation, it is obvious that rejection of the Commissioner's contention would result in permitting the Section 112 exemption to be used as a device for evading taxes Congress intended to impose on many gains actually realized from sales of property. But we upheld the views urged by the Commissioner here, in *Commissioner* v. *Wheeler*, 324 U. S. 542, decided on the same day that the Circuit Court of Appeals handed down its decision in this case. In that case we held that in the second Revenue Act of 1940, 54 Stat. 974, 1004-1005, Congress clarified its original purpose in enacting the 1934 Act and others to require that corporate earnings be computed on a basis of cost of the property to transferors like Fisher. That decision would have controlled the disposition of this case were it not for the fact that on rehearing the Circuit Court of Appeals held that a proviso in the second Revenue Act of 1940 excepted taxpayers like Fisher from liability under the Revenue Act of 1934. That proviso stated that the 1940 Act should not "affect the tax liability of any taxpayer for any year which on September 20, 1940, was pending before, or was theretofore determined by the Board of Tax Appeals, or any Court of the United States." This case was pending before the Tax Court on September 20, 1940, and respondents here contend that the proviso was intended to exempt Fisher from the tax liability to which he would otherwise be subject.

In other words respondents assert that Congress intended by the proviso to pick out a small group of taxpayers and award them special tax exemptions which the whole Act was designed to deny all other taxpayers who did not happen to have tax litigation pending in September 1940. The proviso indicates no such purpose. The proviso means what it says, that the enactment of the 1940 Act was not to affect the tax liability of those who had cases before the Board or Courts, whatever that tax liability under the earlier revenue laws. Under those earlier laws as interpreted by us in the *Wheeler* case, the distribution of General Motors stock to Fisher imposed on him a tax liability which remained unaffected by the enactment of the 1940 statute.

Reversed.

Mr. Justice DOUGLAS, Mr. Justice MURPHY and Mr. Justice JACKSON took no part in the consideration or decision of this case.